Recovery Accelerates

by NORMAN N. BOWSHER

THE TEMPO of economic activity has been quickening. Recovery from the 1969-70 recession began rather slowly, but since late last summer the pace has accelerated. The Census Bureau's composite of leading business indicators rose in April for the tenth consecutive month. Expansionary monetary actions, increased Federal spending, and tax changes have contributed to the greater activity, yet continued progress has been made in reducing the pace of inflation.

Business Developments

Spending – Crucial to any significant economic expansion in our market system is a strong demand for the nation's output, and it appears that such a demand has been developing. Total spending on goods and services rose at an annual rate of 10 percent from the third quarter of 1971 to the first quarter of this year. This compares with rates of 7 percent in the previous year and 4.6 percent in the year before that. Data available for April and May indicate that the growth of spending has continued to rise rapidly in the second quarter of this year.

Not only has demand been vigorous, but recent developments in the housing sector and in the volume of inventories indicate a reserve source of strength to prolong the expansion. Housing starts were at an annual rate of 2.4 million in the first four months of 1972. By comparison, starts were 2.1 million in 1971 and 1.5 million in both 1969 and 1970.

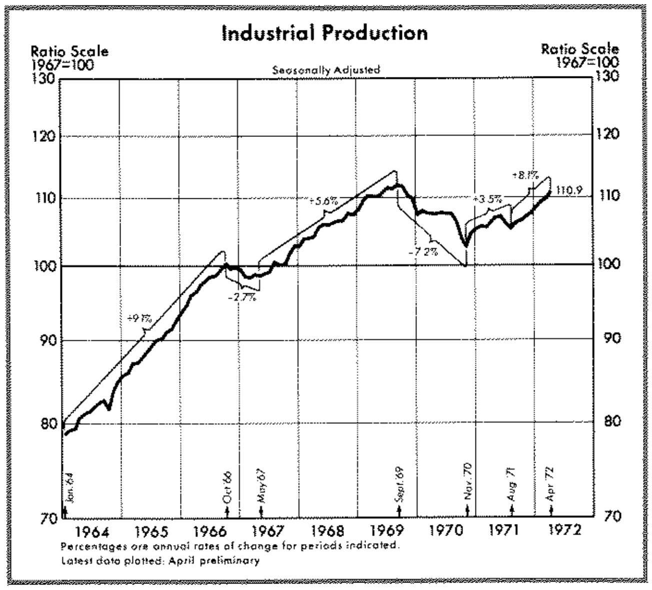
Business sales rose faster than inventories in late 1971 and early 1972 and, as a result, the inventory/sales ratio declined to 1.49 in the first quarter of 1972. By comparison, the ratio averaged 1.55 during 1971 and 1.57 during the four previous years. Unless sales falter, some step-up in inventory accumulation might be expected later this year in view of the relatively low level of stocks currently.

Growth in spending has been accommodated, in part, by a rise in credit outstanding. Real estate loans, consumer credit and business advances have all expanded in recent months. The cost of credit has risen somewhat since February with the increased demand for funds, but remains below average levels of recent years. For example, interest rates on highest grade seasoned corporate bonds averaged 7.3 percent in May and early June, compared with 7.2 percent in January, 7.4 percent in 1971 and 8 percent in 1970.

Production – Reflecting strong demands for goods and services, production has been gaining momentum. Total real output rose at a 5.7 percent annual rate from the third quarter of 1971 to the first quarter of this year. By comparison, real output increased 2.4 percent in the previous year, after declining slightly in the year before that.

Industrial production has been particularly strong with most industry groups sharing in the greater activity. From last August to April, industrial production expanded at an 8.1 percent annual rate. From November 1970, when the economy was at a recession low and hampered by a major automobile strike, to last August production rose at only a 3.5 percent rate.

New construction put in place was at an annual rate of $121.5 billion in the first four months of this year. This was an 18 percent annual rate of increase from the four months ending last September.

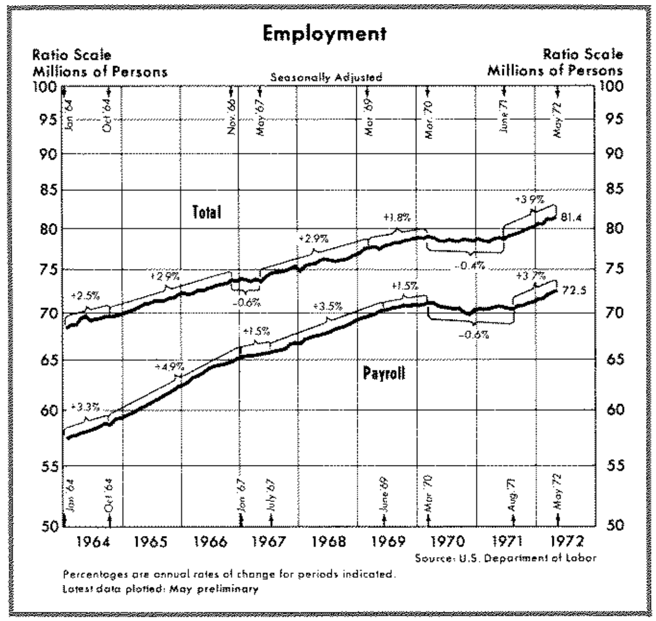


Employment — The greater production has been accomplished by increasing the utilization of the labor force and by a rise in the productivity of labor. Total civilian employment rose at a 3.9 percent annual rate from June 1971 to May after changing little in the previous year and a half. The trend growth in employment was 1.5 percent per year from 1957 to 1971. Average hours worked per week in manufacturing was 40.7 in April and May, up from 39.7 in the three months ending last October.

The widely publicized unemployment rate — which has remained just below 6 percent — has reflected a sharp increase in the labor force as job opportunities have improved. Unemployment among married men declined from 3.2 percent in the third quarter of 1971 to 2.9 percent in the February-May 1972 period. In March, April, and May total employment was an estimated 64.4 percent of the population of working force age (16-64). By comparison, in the third quarter of last year employment amounted to 63.8 percent of this population, and in the relatively prosperous year of 1965 it averaged about 63 percent.

Labor efficiency has also risen. From the second quarter of last year to the first quarter of this year, output per man-hour in the private sector of the economy rose at a 3.1 percent annual rate. By comparison, from early 1966 to the spring of 1971, output per man-hour increased at a 1.9 percent rate.

Income — Together with greater sales, production, and employment, incomes have also been rising. From October of last year to April, total personal income rose at a 9 percent annual rate. Wage and salary disbursements rose at an even faster 12.7 percent rate.



In the previous year total personal income rose 7.1 percent.

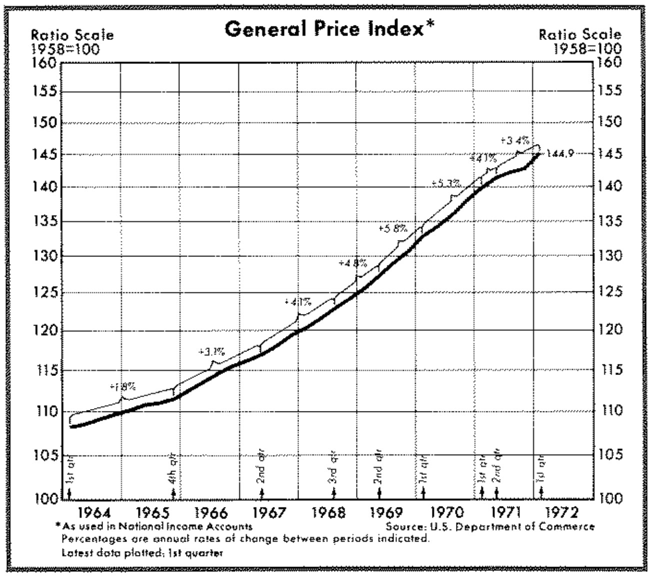
Corporate profits, which had been sluggish since the mid-sixties, rose at an 18 percent annual rate from the third quarter of last year to the first quarter of this year. Nevertheless, profits early this year were only 13 percent higher than their 1965 level, a 14 percent decline in real terms. By sharp contrast, from 1965 to early 1972 wage and salary disbursements increased 70 percent, or 29 percent in real terms.

With improved profits, the climate for further risk-taking is encouraged. Concern has developed, however, that profit margin ceilings might discourage expansion or lead to waste and inefficiency. Thus far, there is little evidence that controls have jeopardized the overall recovery or have reduced efficiency materially.

Inflation

The rate of advance in prices has slowed since last summer, but the pattern has been uneven. During the three-month "freeze" from mid-August to mid-November, wholesale quotations changed little and the rise in consumer prices slowed greatly. After the freeze was lifted, price increases accelerated, as had been expected, but since February price increases have been moderate.

On balance, price developments since last August have continued around the trend toward the less inflation that began in early 1970, and primarily reflect the slack in the economy. It is still too early to evaluate the effect of the price-wage control program on



inflation, but data to date suggest its overall contribution has been marginal. Producing a marked slowing in inflation by direct controls is a difficult task, since more rigorous restraints on prices and wages would be costly to administer and would likely be accompanied by shortages, black markets, quality deterioration, and reduced incentives.

Inflation was most severe, as measured by rates of increase in overall prices (GNP implicit deflator), from the second quarter of 1969 to the first quarter of 1970. In this period, general prices rose at a 5.8 percent annual rate. From early 1970 to early 1971, quotations increased 5.3 percent. In early 1971 price increases were at about a 4 percent rate, and since the second quarter of last year have been at a 3.4 percent rate.

Consumer prices have followed a similar pattern. From March 1969 to June 1970, average markups were at a 6.1 percent annual rate. In the following year ending June 1971, consumer prices rose 4.5 percent. Since last June they have slowed to a 2.8 percent rate.

The trend rate toward less inflation is also evident in the wholesale sector, but the progress has been more erratic since short-run variations in supply conditions generally have a larger effect on wholesale prices than on other prices. From last August to May, wholesale industrial prices rose at a 2.9 percent annual rate, down from the average 3.9 percent rate from October 1968 to August 1971.

Fiscal Developments

Taxing and expenditure actions by the Federal Government had an expansionary effect on the economy during 1970 and 1971. In early 1972 they became moderately restrictive, but this is expected to be reversed soon.

Federal expenditures, on a national income accounts basis, rose at a 4.5 percent annual rate from mid-1968 to the end of 1969. From then until the end of 1970, Federal spending went up 8.5 percent. Since late 1970 it has risen at a 10 percent rate. In addition, last fall personal tax exemptions were increased, excise taxes on automobiles were lowered, and an investment tax credit was legislated.

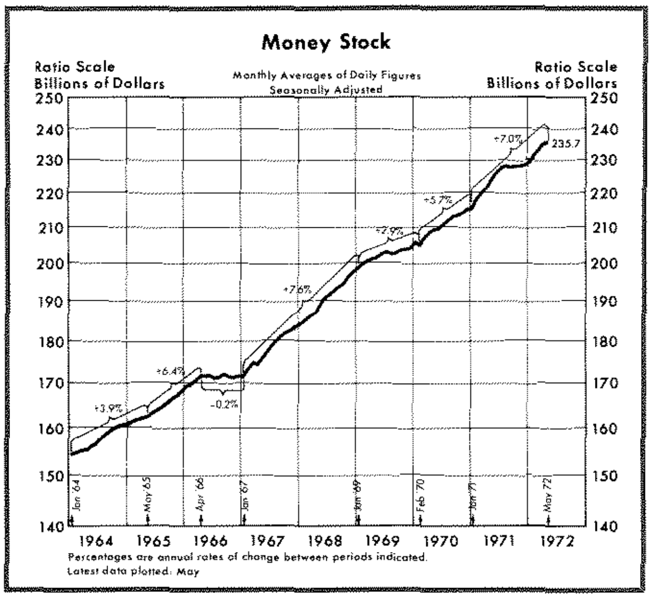
The high-employment budget, which provides an approximate measure of the overall impact of current fiscal actions on economic activity, was $11.4 billion in surplus during 1969. With progressively more stimulative actions, the surplus declined to $6.9 billion in 1970, and further to $1.6 billion in 1971. In the first three months of 1972, however, the surplus rose to roughly an $11 billion annual rate. The marked reversal early this year in the budget was caused, in large part, by over-withholding of individual income tax, an unexpected development which arose with the new withholding tax schedules. This over-withholding is expected to diminish some as the year progresses and will be approximately matched by large refunds in early 1973. Given the projected increases in Government expenditures and the tax payment pattern, the high-employment budget is expected to maintain a small surplus, on average, for the remainder of 1972, then move into a substantial deficit in the first half of 1973.

Monetary Actions

Since 1970 monetary expansion has been more rapid than the earlier trend growth, providing a strong stimulus to economic activity. The money stock of the nation rose at a moderate 2.9 percent annual rate from January 1969 to February 1970. From February 1970 to January 1971, money increased at a 5.7 percent rate, approximately the trend growth since late 1966. From January 1971 to May 1972, it expanded at a faster 7 percent rate.

Underlying the various growth rates of money have been approximately similar expansions in the monetary base. The multiplier relationship between base and money has changed little over this period. Movements in the base, in turn, were largely dominated by changes in Federal Reserve Bank credit.

The trend growth of money, which has its major impact on the trend rate of prices, has accelerated at least twice in the past two decades. From early 1952



until the fall of 1962, money rose at an average 1.7 percent annual rate, and overall prices (GNP deflator) rose at a 1.8 percent rate. From the fall of 1962 to the end of 1966, money rose at a 3.7 percent rate, and after a lag of about three years, prices began increasing at a 3.9 percent rate. From late 1966 to the end of 1971, money rose at a 5.9 percent rate, and from mid-1969 to mid-1971, prices rose at a 5.4 percent rate.

Summary

Spending, production, employment, and income have all risen at an advanced pace since early last fall. The expansion has been fostered, in large measure, by stimulative monetary actions. Increases in Government spending and tax changes have contributed to the increased activity, but the overpayment of taxes by withholding in early 1972 provided some restraint. Reflecting primarily some excess productive capacity in the economy during the past nine months, the rate of inflation has continued to slow, but this slack is decreasing and will soon disappear as an effective anti-inflationary force.